Part III - Administrative, Procedural, and Miscellaneous

Announcement of rules to be included in regulations under section 367(a) regarding the effect of certain exchanges on gain recognition agreements and request for comments

Notice 2005-74

SECTION 1. OVERVIEW

This notice announces that Treasury and the Internal Revenue Service (IRS) will amend the regulations under section 367(a) of the Internal Revenue Code regarding the application of Treas. Reg. §1.367(a)-8, including the provisions addressing the treatment of gain recognition agreements as a result of certain common asset reorganizations involving the U.S. transferor, the transferee foreign corporation, and the transferred corporation. These regulations will supplement the existing rules under Treas. Reg. §1.367(a)-8, including the rules under Treas. Reg. §1.367(a)-8(f) through (h). As described below, taxpayers may rely on this notice for exchanges occurring on or after July 20, 1998 (the effective date of Treas. Reg. §1.367(a)-8).

No inference is intended on the application of the current provisions of Treas. Reg. § 1.367(a)-8 to asset reorganizations, and other transactions, that are not addressed in this notice.

SECTION 2. BACKGROUND

Section 367(a)(1) provides that if, in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person (U.S. transferor) transfers property to a foreign corporation (transferee foreign corporation), such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. Section 367(a)(2), (3) and (6) provides certain exceptions to this general rule and grants regulatory authority to provide additional exceptions and to limit the statutory exceptions.

Exceptions to the general rule of section 367(a)(1) for certain transfers of the stock or securities of a corporation (transferred corporation) are provided in Treas. Reg. §1.367(a)-3. In some cases, these exceptions require, among other things, the filing of a gain recognition agreement, as provided in Treas. Reg. §1.367(a)-8, by the U.S. transferor. Treas. Reg. §1.367(a)-3(b)(1)(ii) and (c)(1)(iii)(B). Pursuant to a gain recognition agreement, the U.S. transferor agrees, among other things, to include in income the gain realized but not recognized on the initial transfer of the stock or securities, plus interest, upon certain events (triggering events) that occur prior to the close of the fifth full taxable year following the year of the transfer. Treas. Reg. §1.367(a)-8(b)(1)(iii) and (3)(i).

Treasury Regulation §1.367(a)-8(e)(1) and (2) provides that dispositions of the stock or securities of the transferred corporation are generally triggering events. Similarly, Treas. Reg. §1.367(a)-8(e)(3) provides that dispositions of substantially all (within the meaning of section 368(a)(1)(C)) of the assets of the transferred corporation are generally treated as deemed dispositions of the stock or securities of the transferred corporation and therefore are also triggering events. Finally, dispositions of stock of the transferee foreign corporation can also be triggering events. See, e.g., Treas. Reg. §1.367(a)-8(f)(2)(ii).

Notwithstanding these rules, Treas. Reg. §1.367(a)-8 provides that certain nonrecognition transactions are not triggering events, if certain requirements are satisfied. For example, Treas. Reg. §1.367(a)-8(g) provides exceptions for certain transactions involving the U.S. transferor, the transferee foreign corporation, and the transferred corporation. In addition, Treas. Reg. §1.367(a)-8(f)(2)(i) provides rules to allow taxpayers to enter into a gain recognition agreement in connection with certain transactions, including asset reorganizations, in which the U.S. transferor goes out of existence as a result of a transaction in which the transferor's gain would have qualified for nonrecognition treatment under Treas. Reg. §1.367(a)-3(b) or (c), had the U.S. transferor remained in existence and entered into a gain recognition agreement. Commentators have stated that although these exceptions clearly contemplate certain nonrecognition transactions, it is not clear whether, and if so how, the exceptions apply to various asset reorganizations involving the U.S. transferor, the transferee foreign corporation, and the transferred corporation.

Treasury Regulation §1.367(a)-8 also provides that certain nonrecognition transactions are not triggering events because the gain recognition agreement is terminated and has no further effect. For example, Treas. Reg. §1.367(a)-8(h)(3) lists certain nonrecognition transactions that terminate the gain recognition agreement, provided that immediately after the transaction the basis in the transferred stock is not greater than the U.S. transferor's basis in the stock that, immediately prior to the initial transfer, necessitated the gain recognition agreement.

Finally, many of the transactions described above may be subject to the provisions of section 367(b) and the regulations thereunder.

SECTION 3. EFFECT OF CERTAIN ASSET REORGANIZATIONS ON GAIN RECOGNITION AGREEMENTS

.01 *Definition of the Terms Asset Reorganization, Consolidated Group, and Common Parent*

For purposes of sections 3.02 and 4.02 of this notice, the term asset reorganization means a reorganization described in section 368(a)(1) involving the transfer of assets by a corporation to another corporation pursuant to section 361, except that such term shall include reorganizations described in section 368(a)(1)(D) or (G) only if the requirements of section 354(b)(1)(A) and (B) are met. For purposes of sections 3.03 and 3.04 of this notice, the term asset reorganization has the same meaning as used for sections 3.02 and 4.02 of this notice, except that the following reorganizations are excluded: (1) triangular asset reorganizations described in Treas. Reg. §1.358-6(b); and (2) asset

reorganizations where, after the reorganization, the same corporation is both the transferee foreign corporation (or successor transferee foreign corporation, as applicable) and the transferred corporation (or the successor transferred corporation, as applicable). This may occur, for example, where the transferee foreign corporation transfers all of its assets (including stock of the transferred corporation) to the transferred corporation pursuant to section 361. However, see section 6 of this notice, requesting comments with respect to those transactions excluded from the definition of an asset reorganization for purposes of sections 3.03 and 3.04 of this notice.

For purposes of this notice, the term consolidated group has the same meaning provided in Treas. Reg. §1.1502-1(h), and the term common parent has the same meaning as in section 1504.

.02 *Transfers of Transferee Foreign Corporation's Stock by U.S. Transferor*

If, during the period a gain recognition agreement is in effect, the original U.S. transferor transfers all or a portion of the stock of the transferee foreign corporation to an acquiring corporation (successor U.S. transferor) pursuant to an asset reorganization, the exchanges made pursuant to such asset reorganization will trigger the gain recognition agreement, unless the following conditions are satisfied:

(A) In the year of the transfer for which the original gain recognition agreement was executed, the U.S. transferor was a member of a consolidated group (original consolidated group), and the common parent of such group (U.S.

parent corporation) entered into the original gain recognition agreement pursuant to Treas. Reg. §1.367(a)-8(a)(3);

(B) Immediately after the asset reorganization, the successor U.S. transferor is a member of the original consolidated group;

(C) The U.S. parent corporation of the original consolidated group (or new U.S. parent corporation, if such corporation became the new common parent of the original consolidated group in a transaction in which the group remained in existence) enters into a new gain recognition agreement pursuant to which it agrees to recognize gain (during the remaining term of the original gain recognition agreement), in accordance with the rules of Treas. Reg. §1.367(a)-8(b), with respect to the transfer subject to the original gain recognition agreement, modified by substituting the successor U.S. transferor in place of the original U.S. transferor and agreeing to treat the successor U.S. transferor as the original U.S. transferor for purposes of Treas. Reg. §1.367(a)-8 and this notice; and

(D) The successor U.S. transferor provides with its next annual certification (described in Treas. Reg. § 1.367(a)-8(b)(5)) the new gain recognition agreement and a notice of the transfer setting forth the following:

(i) A description of the transfer (including the date of such transfer), and the successor U.S. transferor's name, address, and taxpayer identification number; and

(ii) A statement that arrangements have been made, in connection with the asset reorganization, ensuring that the successor U.S. transferor will be

informed of any subsequent disposition of property with respect to which recognition of gain would be required under the new gain recognition agreement (and any related information that is necessary to comply with Treas. Reg. §1.367(a)-8 and this notice).

The following example illustrates the application of this section 3.02.

Example 1. (i) Facts. USP, a domestic corporation, is the common parent of a consolidated group. USP owns 100% of the stock of two domestic corporations that are members of the USP group, S1 and S2. S1 owns 100% of two foreign corporations, FC1 and FC2. In Year 1, S1 transfers 100% of the stock of FC1 to FC2 in an exchange described in section 351 and, pursuant to Treas. Reg. §§1.367(a)-3(b)(1)(ii) and 1.367(a)-8, USP enters into a gain recognition agreement with respect to such transfer. In Year 4, in a reorganization described in section 368(a)(1)(D), S1 transfers all of its assets, including the stock of FC2, to S2 in exchange for S2 stock. S1 transfers the S2 stock to USP in exchange for the S1 stock held by USP and the S1 stock is canceled. No taxable years of the USP group are short taxable years.

(ii) Analysis. Because USP and S2 are, immediately after the reorganization, members of the consolidated group of which S1 was a member, and USP was the common parent which entered into the original gain recognition agreement in year 1 pursuant to Treas. Reg. §1.367(a)-8(a)(3), the transaction satisfies the requirements of section 3.02(A) and (B) of this notice. As a result, the transfer of the FC2 stock will not trigger the gain recognition agreement if, pursuant to section 3.02 of this notice, USP enters into a new gain recognition agreement, in which it agrees to recognize gain with respect to the transfer subject to the original gain recognition agreement as described in section 3.02(C) of this notice, and S2 complies with the reporting requirements contained in section 3.02(D) of this notice. For purposes of the new gain recognition agreement, Treas. Reg. §1.367(a)-8, and this notice, S2 is the successor U.S. transferor and is treated as the original U.S. transferor, FC2 continues to be the transferee foreign corporation, and FC1 continues to be the transferred corporation. The new gain recognition agreement applies through the close of Year 6 (the remaining term of the original gain recognition agreement filed by USP).

.03 *Transfers of Transferred Corporation's Stock or Securities by Transferee Foreign Corporation to a Foreign Acquiring Corporation*

If, during the period a gain recognition agreement is in effect, the original transferee foreign corporation transfers all or a portion of the stock or securities of the transferred corporation to a foreign acquiring corporation (successor transferee foreign corporation) in an asset reorganization, the exchanges made pursuant to such reorganization will trigger the gain recognition agreement, unless the following conditions are satisfied:

(A) The U.S. transferor, U.S. parent corporation or new U.S. parent corporation, as applicable, enters into a new gain recognition agreement pursuant to which it agrees to recognize gain (during the remaining term of the original gain recognition agreement), in accordance with the rules of Treas. Reg. §1.367(a)-8(b), with respect to the transfer subject to the original gain recognition agreement, substituting the successor transferee foreign corporation in place of the original transferee foreign corporation, and agreeing to treat the successor transferee foreign corporation as the original transferee foreign corporation for purposes of Treas. Reg. §1.367(a)-8 and this notice; and

(B) The U.S. transferor provides with its next annual certification (described in Treas. Reg. §1.367(a)-8(b)(5)) the new gain recognition agreement and a notice of the transfer setting forth the following:

(i) A description of the transfer (including the date of such transfer), and the successor transferee foreign corporation’s name, address, and taxpayer identification number (if any); and

(ii) A statement that arrangements have been made, in connection with the asset reorganization, ensuring the U.S. transferor will be informed of any

subsequent disposition of property with respect to which recognition of gain would be required under the new gain recognition agreement (and any related information that is necessary to comply with Treas. Reg. §1.367(a)-8 and this notice).

The following example illustrates the application of this section 3.03.

Example 2. (i) Facts. USP, a domestic corporation, owns 100% of the stock of three foreign corporations, FC1, FC2 and FC3. In Year 1, USP transfers 100% of the stock of FC1 to FC2 in an exchange described in section 351 and, pursuant to Treas. Reg. §§1.367(a)-3(b)(1)(ii) and 1.367(a)-8, enters into a gain recognition agreement with respect to such transfer. In Year 4, in a reorganization described in section 368(a)(1)(D), FC2 transfers all of its assets, including the stock of FC1, to FC3 in exchange for FC3 stock. FC2 transfers the FC3 stock to USP in exchange for FC2 stock held by USP and the FC2 stock is canceled. No taxable years of USP are short taxable years.

(ii) Analysis. Pursuant to section 3.03 of this notice, the transfer of the FC1 stock to FC3 in exchange for FC3 stock and the exchange of the FC2 stock for FC3 stock will not trigger the gain recognition agreement if, in addition to complying with the reporting requirements of section 3.03(B) of this notice, USP enters into a new gain recognition agreement pursuant to which it agrees to recognize gain with respect to the transfer subject to the original gain recognition agreement, substituting FC3 as the successor transferee foreign corporation in place of FC2, and treating FC3 as the original transferee foreign corporation for purposes of Treas. Reg. §1.367(a)-8 and this notice. Thus, for purposes of the new gain recognition agreement, Treas. Reg. §1.367(a)-8, and this notice, USP continues to be the U.S. transferor, FC3 is the successor transferee foreign corporation and is treated as the original transferee foreign corporation, and FC1 continues to be the transferred corporation. The new gain recognition agreement applies through the close of year 6 (the remaining term of the original gain recognition agreement filed by USP). This transaction is also subject to the provisions of section 367(b), including Treas. Reg. §1.367(b)-4.

.04 *Transfers of Substantially All of Transferred Corporation's Assets*

If, during the period a gain recognition agreement is in effect, the original transferred corporation transfers substantially all of its assets to an acquiring corporation (successor transferred corporation) pursuant to an asset reorganization, the exchanges made pursuant to such asset reorganization will

trigger the gain recognition agreement, unless the following conditions are satisfied:

(A) The U.S. transferor, U.S. parent corporation, or new U.S. parent corporation, as applicable, enters into a new gain recognition agreement pursuant to which it agrees to recognize gain (during the remaining term of the original gain recognition agreement), in accordance with the rules of Treas. Reg. §1.367(a)-8(b), with respect to the transfer subject to the original gain recognition agreement, modified by:

(i) Substituting the successor transferred corporation in place of the original transferred corporation and agreeing to treat the successor transferred corporation as the original transferred corporation for purposes of Treas. Reg. §1.367(a)-8 and this notice; and

(ii) Treating only the assets acquired by the successor transferred corporation from the original transferred corporation pursuant to the asset reorganization as the assets subject to the deemed disposition of stock rules under Treas. Reg. §1.367(a)-8(e)(3)(i); and

(B) The U.S. transferor provides with its next annual certification (described in Treas. Reg. §1.367(a)-8(b)(5)) the new gain recognition agreement and a notice of the transfer setting forth the following:

(i) A description of the transfer (including the date of such transfer), and the successor transferred corporation’s name, address, and taxpayer identification number (if any); and

(ii) A statement that arrangements have been made, in connection with the asset reorganization, ensuring the U.S. transferor will be informed of any subsequent disposition of property with respect to which recognition of gain would be required under the new gain recognition agreement (and any related information that is necessary to comply with Treas. Reg. §1.367(a)-8 and this notice).

The following example illustrates the application of this section 3.04.

Example 3. (i) Facts. USP, a domestic corporation, owns 100% of the stock of two foreign corporations, FC1 and FC2. In Year 1, USP transfers 100% of the stock of FC1 to FC2 in an exchange described in section 351 and, pursuant to Treas. Reg. §§1.367(a)-3(b)(1)(ii) and 1.367(a)-8, enters into a gain recognition agreement with respect to such transfer. In Year 4, in a reorganization described in section 368(a)(1)(C), FC1 transfers all of its assets to FC3, an unrelated foreign corporation, in exchange for FC3 stock. FC1 transfers the FC3 stock to FC2 in exchange for the FC1 stock held by FC2 and the FC1 stock is canceled. No taxable years of USP are short taxable years.

(ii) Analysis. Pursuant to section 3.04 of this notice, the transfer of the FC1 assets to FC3 in exchange for FC3 stock and the exchange of the FC1 stock for FC3 stock will not trigger the gain recognition agreement if, in addition to complying with the reporting requirements of section 3.04(B) of this notice, USP enters into a new gain recognition agreement pursuant to which it agrees to recognize gain with respect to the transfer subject to the original gain recognition agreement, substituting FC3 as the successor transferred corporation in place of FC1, treating FC3 as the original transferred corporation for purposes of Treas. Reg. §1.367(a)-8 and this notice, and treating only the assets acquired by FC3 from FC1 pursuant to the section 368(a)(1)(C) reorganization as assets subject to the deemed disposition of stock rules under Treas. Reg. §1.367(a)-8(e)(3)(i). Thus, for purposes of the new gain recognition agreement, Treas. Reg. §1.367(a)-8, and this notice, USP continues to be the U.S. transferor, FC2 continues to be the transferee foreign corporation, and FC3 is the successor transferred corporation and is treated as the original transferred corporation. The new gain recognition agreement applies through the close of Year 6 (the remaining term of the original gain recognition agreement filed by USP). This transaction is also subject to the provisions of section 367(b), including Treas. Reg. §1.367(b)-4.

SECTION 4. OTHER MODIFICATIONS

.01 *Modification of Treas. Reg. §1.367(a)-8(f)(2)(i)*

For purposes of determining, under Treas. Reg. §1.367(a)-8(f)(2)(i), whether a U.S. transferor corporation is owned by a single U.S. parent corporation, all members of the U.S. parent corporation's consolidated group for the taxable year that includes the transfer shall be treated as a single corporation.

.02 *Certain Nonrecognition Transfers of Stock of the Transferee Foreign Corporation by the U.S. Transferor under Treas. Reg. §1.367(a)-8(g)(1)*

If a U.S. transferor disposes of any stock of the transferee foreign corporation in a nonrecognition transfer, other than pursuant to an asset reorganization, the gain recognition agreement will be triggered, unless the U.S. transferor satisfies the requirements of Treas. Reg. §1.367(a)-8(g)(1), in which case the U.S. transferor will continue to be subject to the terms of the original gain recognition agreement as provided under Treas. Reg. §1.367(a)-8(g)(1). See section 3.02 of this notice providing rules for asset reorganizations.

.03 *Basis of Transferred Stock for Purposes of Treas. Reg. §1.367(a)-8(h)(3)*

For purposes of determining whether, immediately following a transaction described in Treas. Reg. §1.367(a)-8(h)(3), the U.S. transferor's basis in the transferred stock is less than or equal to the basis that it had in the transferred stock immediately prior to the original transfer that necessitated the gain recognition agreement, only the basis in the stock transferred shall be taken into account. Thus, for example, the basis of stock that is issued (or deemed to be issued) by the transferred corporation to the transferee foreign corporation in

connection with subsequent transfers of property from the transferee foreign corporation to the transferred corporation shall not be taken into account.

Example 4. (i) Facts. USP, a domestic corporation, owns 100% of the stock of two foreign corporations, FC1 and FC2. In Year 1, USP transfers 100% of the stock of FC1 to FC2 in an exchange described in section 351 and, pursuant to Treas. Reg. §§1.367(a)-3(b)(1)(ii) and 1.367(a)-8, enters into a gain recognition agreement with respect to such transfer. In Year 2, FC2 transfers property to FC1 in exchange for newly issued FC1 stock. In Year 4, FC2 distributes all of its FC1 stock to USP in a liquidating distribution that qualifies under sections 332 and 337.

(ii) Result. In determining whether the gain recognition agreement entered into by USP is terminated, or in the alternative triggered, only the stock of FC1 transferred by USP to FC2 in Year 1 is considered in determining whether immediately following the section 332 liquidation, USP's basis in the transferred stock is less than or equal to the basis that it had in such stock immediately prior to the initial transfer that necessitated the gain recognition agreement. Thus, the basis in the FC1 stock issued to FC2 in Year 2, in exchange for property, is not taken into account. The result in this example would remain the same if, instead of FC1 actually issuing stock to FC2 in exchange for the transferred property, FC1 was deemed to issue stock to FC2 in exchange for such property.

SECTION 5. EFFECTIVE DATE

Regulations to be issued incorporating the guidance set forth in this notice will apply to gain recognition agreements filed with respect to exchanges of stock or securities occurring on or after September 28, 2005. Until such regulations are issued, taxpayers may rely on this notice. Taxpayers also may apply the provisions of this notice to gain recognition agreements with respect to transfers of stock or securities, for all open years, occurring on or after July 20, 1998 and before September 28, 2005. Taxpayers applying this notice, however, must do so consistently to all transactions within its scope for all open years.

If an exchange that is addressed by this notice occurred on or after July 20, 1998, but prior to September 28, 2005**,** and the taxpayer chooses to rely on

this notice for purposes of such exchange, then the taxpayer shall be treated as having timely satisfied the requirements for filing new gain recognition agreements (and related certifications and reporting), as required by Treas. Reg. §1.367(a)-8 and described in section 3 of this notice, if such U.S. person attaches such new gain recognition agreement (and related certifications and reporting) to its timely filed (including extensions) original tax return for the taxable year that includes September 28, 2005.

SECTION 6. COMMENTS

Treasury and the IRS are considering issuing subsequent public guidance that addresses additional issues under Treas. Reg. §1.367(a)-8. Accordingly, comments are requested regarding the application of Treas. Reg. §1.367(a)-8, including whether other transactions should be excepted from being treated as triggering events pursuant to rules similar to those contained in this notice. For example, comments are requested as to the most appropriate treatment of asset reorganizations that do not satisfy the conditions described in section 3.02(A) or 3.02(B) of this notice. In addition, comments are requested as to the most appropriate treatment of certain upstream and downstream reorganizations (including those in which the same corporation becomes both the transferee foreign corporation and transferred corporation, as described in section 3.01 of this notice), and divisive reorganizations qualifying under section 368(a)(1)(D) or (G), involving the U.S. transferor corporation, the foreign transferee corporation, and the transferred corporation. Comments also are requested as to whether rules similar to the rules contained in section 3.03 and 3.04 should apply to

triangular reorganizations and, if so, how such rules would apply. Finally, comments are requested as to other transactions which should terminate a gain recognition agreement pursuant to Treas. Reg. § 1.367(a)-8(h)(3) when the stock of the transferred corporation is transferred to the U.S. transferor (or other U.S. person).

Written comments on the issues addressed in this notice may be submitted to the Office of Associate Chief Counsel International, Attention: Notice 2005-74, room 4567**,** CC:INTL:BR4, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, 20224. Alternatively, taxpayers may submit comments electronically to Notice.Comments@m1.irscounsel.treas.gov. Comments will be available for public inspection and copying.

SECTION 7. PAPERWORK REDUCTION ACT

Collections of information referenced in this notice have been previously reviewed and approved under control number 1545-1271.

SECTION 8. DRAFTING INFORMATION

The principal author of this notice is Christopher L. Trump of the Office of Associate Chief Counsel (International). For further information regarding this notice contact Christopher L. Trump at (202) 622-3860 (not a toll-free call).